BILL ANALYSIS

DRAFT 2007-SVz-23: Revenue Laws Technical, Clarifying, & Administrative Changes – Part II

Committee:	Revenue Laws Study Committee	**Date:**	April 30, 2008
Introduced by:		**Summary by:**	Trina Griffin
Version:	2007-SVz-23		Committee Counsel

SUMMARY: This legislative proposal represents 'Part II' of the Revenue Laws Technical Changes bill, which makes several technical, clarifying, and administrative changes to the revenue laws and related statutes.

BILL ANALYSIS: This draft proposal makes the following technical, clarifying, and administrative changes:

Section	Explanation
Reform Tax Appeals Changes	
1.(a)	Under the new administrative review process, the Department is required to take action on a request for a refund within six months after the request has been filed. If the Department denies the request, it must send a notice to the taxpayer, and the taxpayer has 45 days to request a review of the proposed denial. However, if the Department fails to take any action within six months, the request is considered denied, and the taxpayer has 45 days from that point to request review. The purpose of this provision is to allow the taxpayer to move forward in the administrative review process despite inaction by the Department. However, concerns have been raised that the running of this 45-day period without actual notice from the Department may create a potential trap that bars taxpayers from appealing the denial. Section 3.(a) provides that a taxpayer may file a request for review at any time after inaction by the Department is considered a proposed denial of the refund but within 45 days of receiving actual notice of a proposed denial by the Department. This change was requested by the Department.
1.(b)	This is a conforming change in the motor fuel tax law regarding the new administrative review process.
1.(c)	SB 242 made special provisions for contested tax cases heard at the Office of Administrative Hearings. Among them, a law enforcement report may be admitted into evidence without the testimony of personnel from the law enforcement agency. The Motor Fuels Tax Division of the Department has requested that government agency lab reports used in the enforcement of the motor fuel tax laws also be admitted without requiring agency personnel testimony.
Collection Changes	
2	Individual officers and directors of a corporation are usually not liable for corporate debts or obligations. This is in contrast to partnership debts and liabilities, which are chargeable personally to the individual partners. However, by statute, a "responsible officer" of a corporation or a limited liability company may be held personally liable for certain unpaid trust taxes owed by the business entity. These taxes include sales and use, motor fuels, and income withholding taxes. A "responsible officer" is defined as

	the president, treasurer, and the CFO of a corporation, the manager of a LLC, and any other officer of a corporation or a member of a LLC who has a duty to pay taxes on behalf of the entity. The Department is authorized to enforce collection by proposing an assessment against the officer. There is no similar statutory authorization to assess partners for these taxes. Instead, the Department, like any other creditor of a partnership, must sue in order to collect this liability. Once a judgment is obtained, the Department may seek to execute the judgment. The Department has requested that partners and managers of a partnership (who may or may not be a partner) be added to the list of officers or, as rewritten, "responsible persons" whom the Department may assess. This section also rewrites the section for clarity and style and places the statute in a more logical location within the Article.
Sales Tax Changes	
3	This section is a transitional provision for the "Medicaid swap" enacted in the 2007 Session by S.L. 2007-323. Under the swap, the local sales and use tax rate decreases by ¼ cent in 2008-09 and again in 2009-10, and the State sales and use tax rate increases by the same amount. The combined State and local rates do not change; instead, the allocation of the combined rate between the State and the counties changes. The question arises of how to report tax on gross receipts from periodic payments made pursuant to agreements entered into before the effective date of the rate changes. This section specifies how the tax on those receipts is to be reported. Periodic payments consist of lease and rental payments and installment sale payments. Sales and use tax is due on lease and rental payments when the payments are billed. For installment sales, the tax application differs depending on whether the retailer reports on an accrual basis or a cash basis. A retailer on an accrual basis reports all the sales tax due on an installment sale when the sale is made. A retailer on a cash basis reports sales tax when each installment payment is received. This provision requires retailers who receive periodic payments from existing contracts to report them at the current State and local rates. This eliminates confusion about what to report and how to report it. Without this provision, a retailer who receives periodic payments will have receipts from existing contracts that are reportable at State and local rates that differ from the State and local rates that apply to periodic payments from new contracts.
Occupancy Tax Changes	
4.(a)	As the result of an independent audit by at least one county, questions have arisen among local governments and within the tourism industry regarding what constitutes "gross receipts" for occupancy tax purposes. Most local occupancy tax acts state that a county or city may levy a room occupancy tax on "the gross receipts derived from the rental of any room…that is subject to sales tax imposed by the State under G.S. 105-164.4(a)(3)." Therefore, if an item of tangible personal property or a fee associated with the rental of an accommodation is subject to sales tax under G.S. 105-164.4(a)(3), then it is also subject to the local occupancy tax. While the Department can offer an interpretation of the State sales tax laws, it does not have statutory authority to offer an interpretation of the application of local occupancy

	tax laws, which it does not administer. This section provides that an interpretation by the Department of a State sales tax law applies to a local law that refers to the State sales tax law for its application.
4.(b) & (c)	In January of 2008, the Department issued a technical bulletin related to the rentals of accommodations. In that bulletin, the Department clarified that the bundling provisions in G.S. 105-164.4D apply to vacation packages. For example, a vacation package may include lodging, meals, and greens fees for one price. The lodging would be subject to sales and local occupancy tax, the meals would be subject only to sales tax, and the greens fees would not be subject to either sales or occupancy tax. The bundling provisions allow a hotel operator to allocate the revenues between taxable and exempt portions of the package. The allocation may be part of a hotel's internal records and is not required to appear on the customer's bill. A "bundled transaction" is defined as a sale that includes at least one taxable item and at least one exempt item. Since the release of the bulletin, the tourism industry has sought clarification of whether the allocation rules apply to vacation packages consisting only of taxable items, since those packages do not otherwise meet the definition of a bundled transaction. The clarification is needed because although the entire vacation package may be subject to *sales* tax, not all items may be subject to *occupancy* tax. The collectors would like the ability to allocate those revenues. This section provides that collectors of occupancy tax may allocate revenues for vacation packages that do not otherwise meet the definition of a bundled transaction.
Medicaid Technical Changes	
5	This section makes two changes. The first change is in G.S. 105-522(a)(2), which is set out in subsection (a) of the section. It is a technical change that describes the hold harmless calculation in a simpler way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. The second change, made in the rest of the section, eliminates a potentially circular calculation of the amount of local sales and use tax revenue to be distributed. It does not change the amount of any tax or hold harmless payment. Currently, the law could be construed to calculate the amount of various hold harmless payments on the basis of an amount that includes a deduction for the payment that is attempted to be calculated, which is circular. The hold harmless payments are now both pegged, in part, on amounts distributed under Article 39 of Chapter 105 of the General Statutes and deducted from those amounts. Section 1 resolves this problem by making it clear that the hold harmless payments are calculated on the basis of amounts allocated for distribution before any subtraction for the hold harmless payments. References in Article 39 and Chapter 1096 of the 1967 Session Laws are replaced with a direction in G.S. 105-522(b) to deduct the city hold harmless payment from the amount of local sales and use tax revenue otherwise allocated under those provisions for distribution to a county. Subsection (a) adds an instruction in G.S. 105-522(b) to deduct the payment. Subsection (b) removes the

	instruction from Article 39 of Chapter 105. Subsection (c) removes the instruction from Chapter 1096.
6	This section makes three changes. First, it inserts the city hold harmless amount into the calculation of the county hold harmless payment, thereby ensuring that the intent of the General Assembly is fulfilled. G.S. 105-523(a) states that each county is to benefit from the "Medicaid swap" by at least $500,000. The current calculation for determining a county's hold harmless payment, however, does not include the amount a county is required to give to its cities in order to hold them harmless from the repealed local sales taxes. Subsection (a) adds the cost of the city hold harmless to the calculation of the county hold harmless payment. Subsections (d) and (f) repeal changes to G.S. 105-523 that were to take effect in 2009, and subsection (h) reinserts those same changes into the amended G.S. 105-523 while preserving the amendments added by subsection (a). Second, it makes the same technical change to G.S. 105-523(b)(3) that Section 1 makes to G.S. 105-522(a)(2). The technical change describes the hold harmless calculation in a simpler way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. Third, it changes the city hold harmless formula and the county hold harmless formula that apply to fiscal years beginning in 2009-2010 to match these formulas to the ones used in the tables that calculated the impact of the swap. The current law incorrectly includes a ¼% tax distributed on the basis of point of origin as one of the elements of the formulas. The "Medicaid swap" is based on the repeal of ½% local sales and use taxes distributed on a per capita basis and the conversion of a ¼% per capita tax to a ¼% point of origin tax. To reflect this, the current reimbursement formula needs to be changed to delete the reference to a ¼% point of origin tax and replace it with a ¼% per capita tax. Subsections (c), (d), and (f) of this section repeal the provisions that contain the incorrect reference and subsections (g) and (h) insert the correct reference in the formulas. Subsections (b), (e), and (i) make conforming changes; they repeal sections that use terminology that does not match the revised reimbursement sections and replace them with a provision that uses terminology that is consistent with the revised sections.